



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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Michigan *Office of the Auditor General* **REPORT SUMMARY**

Performance Audit

Customer Contact Process

Department of Treasury

Report Number:
271-0295-05

Released:
December 2006

Tax-related customer contact and business registration functions are primarily the responsibility of the Customer Contact Division (CCD), Department of Treasury. The goals of CCD are to provide high quality responses to taxpayers related to tax laws and taxpayer accounts, to provide timely and efficient customer communication, to make available self-service options, and to streamline customer service processes.

Audit Objective:

To assess the Department's effectiveness in performing its single business tax (SBT)/sales, use, and withholding (SUW) business registration functions.

Audit Conclusion:

We concluded that the Department was moderately effective in performing its SBT/SUW business registration functions. We noted a reportable condition related to business registration (Finding 1).

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Audit Objective:

To assess the Department's effectiveness in communicating with taxpayers.

Audit Conclusion:

We concluded that the Department was effective in communicating with taxpayers. However, we noted a reportable condition related to refund interest (Finding 2).

Noteworthy Accomplishments:

In 2002, the Department implemented a Customer Relationship Management (CRM) system that provides a comprehensive contact tracking system. The CRM system provides a mechanism for documenting reasons for customer contacts and the internal processes involved in resolution of customer issues.

In 2003, the Department implemented a quality assurance program to monitor the effectiveness of its customer service representatives' communication with customers. The program included an evaluation of the customer service representative's audio and written screen recordings followed by feedback and training.

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Audit Objective:

To assess the effectiveness of the Department's procedures in maintaining SUW taxpayer accounts and resolving account discrepancies.

Audit Conclusion:

We concluded that the Department's procedures were effective in maintaining SUW taxpayer accounts and resolving account discrepancies. However, we noted a reportable condition related to access controls (Finding 3).

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Agency Response:

Our audit report includes 3 findings and 3 corresponding recommendations. The Department's preliminary response indicates that it agrees with all the recommendations.

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

December 12, 2006

Mr. Robert J. Kleine
State Treasurer
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine:

This is our report on the performance audit of the Customer Contact Process, Department of Treasury.

This report contains our report summary; description of process; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Process

Tax-related customer contact and business registration functions are primarily the responsibility of the Customer Contact Division (CCD), Department of Treasury. The goals* of CCD are to provide high-quality responses to taxpayers related to tax laws and taxpayer accounts, to provide timely and efficient customer communication, to make available self-service options, and to streamline customer service processes.

In addition, the Department's Return Processing Division and CCD each have responsibilities for processing annual business tax returns, individual income tax (IIT) returns, and taxpayer inquiries, and each can initiate tax overpayment refunds.

In 2002, the Department developed an integrated Customer Relationship Management (CRM) System that links return processing, customer service, and some audit functions to a database for tracking customer contacts. Prior to establishment of CCD, taxpayers could have contacted numerous locations within the Department seeking answers to their tax questions, possibly resulting in inconsistent responses with limited or no tracking of customer interactions or results of the contacts. The Department indicated that CRM System benefits include:

1. Accurate tracking of customer contacts used to:
 - a. Report customer issues to senior management.
 - b. Predict customer response to specific activities which, in turn, provides for the potential for improved response time to incoming contacts.
 - c. Develop specific training for responding to inbound correspondence and apply staff resources toward high-volume customer contact areas.
 - d. Identify potential changes for processing tax returns.
2. Increased knowledge of the impact of outbound communications on the resolution of customer issues.
3. Development of a quality assurance component to measure the quality of customer interactions in conjunction with customer satisfaction survey results.

The Department provides numerous communication options for persons to obtain individual income tax information. Such options include contacts by agency-assisted telephone service, interactive voice response* (IVR), the Department's Web site, paper

* See glossary at end of report for definition.

correspondence, and e-mail. In an effort to serve more customers, the Department is migrating more traffic away from agency-assisted telephone calls and correspondence to the self-service channels of IVR and the Web site. During calendar year 2004, CCD handled approximately 223,000 individual income taxpayer telephone inquiries; 1.7 million IVR inquiries; 314,000 Web site self-service requests; 22,500 pieces of paper correspondence; and 4,900 e-mail service requests.

Also, CCD is responsible for providing timely resolution of customers' business tax inquiries and for registering new businesses for applicable business-related taxes. In addition, CCD is responsible for monitoring taxpayers' filing of monthly, quarterly, or annual business tax returns. During calendar year 2004, CCD received approximately 162,000 business taxpayer telephone inquiries and 38,600 pieces of paper correspondence.

CCD incurred expenditures of approximately \$7.4 million for the fiscal year ended September 30, 2005 and had 173 full-time equated positions as of September 2005.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of Customer Contact Process, Department of Treasury, had the following objectives:

1. To assess the Department's effectiveness* in performing its single business tax (SBT)/sales, use, and withholding (SUW) business registration functions.
2. To assess the Department's effectiveness in communicating with taxpayers.
3. To assess the effectiveness of the Department's procedures in maintaining SUW taxpayer accounts and resolving account discrepancies.

Audit Scope

Our audit scope was to examine the program and other records related to the Department's customer contact process. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, conducted from May through December 2005, included examination of the Department's records and activities primarily for the period October 1, 2002 through July 31, 2005.

We conducted a preliminary review of the Department's customer contact process to formulate a basis for defining the audit objectives and scope. Our review included interviewing Department personnel and reviewing applicable statutes, goals and objectives, performance measures, reports, and other reference materials.

To assess the Department's effectiveness in performing its SBT/SUW business registration functions, we reviewed the State's business tax registration requirements. We examined the Department's procedures for registering new businesses and

* See glossary at end of report for definition.

processing registration applications. We matched the Department's listing of registered businesses to the Michigan Unemployment Insurance Agency's employer quarterly tax reports to identify potential unregistered businesses. In addition, we reviewed the Department's procedures for registering unregistered businesses that submitted tax payments.

To assess the Department's effectiveness in communicating with taxpayers, we reviewed the Department's taxpayer communication goals and work performance statistics to determine if communication with taxpayers was timely and effective in meeting taxpayer needs. We examined taxpayer surveys to obtain an understanding of taxpayer concerns and reviewed the agency program changes made related to the survey results. We analyzed correspondence supplied to taxpayers to evaluate its effectiveness in communicating the reasons for tax return and refund changes. Also, we reviewed the Department's process for reviewing taxpayer correspondence and issuing tax refunds.

To assess the effectiveness of the Department's procedures for maintaining SUW taxpayer accounts and resolving account discrepancies, we interviewed Department personnel to obtain an understanding of the SUW payment process. We identified the reasons for SUW account discrepancies and evaluated the Department's procedures to resolve those discrepancies and educate users to help prevent future discrepancies. In addition, we evaluated the Department's controls over employees' access to the SUW and registration computer systems.

We use a risk and opportunity based approach when selecting activities or programs to be audited. Accordingly, our audit efforts are focused on activities or programs having the greatest probability for needing improvement as identified through a preliminary review. By design, our limited audit resources are used to identify where and how improvements can be made. Consequently, our performance audit reports are prepared on an exception basis. To the extent practical, we add balance to our audit reports by presenting noteworthy accomplishments for exemplary achievements identified during our audits.

Agency Responses

Our audit report includes 3 findings and 3 corresponding recommendations. The Department's preliminary response indicates that it agrees with all the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Treasury to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

PERFORMING SBT/SUW BUSINESS REGISTRATION FUNCTIONS

COMMENT

Audit Objective: To assess the Department of Treasury's effectiveness in performing its single business tax (SBT)/sales, use, and withholding (SUW) business registration functions.

Conclusion: We concluded that the Department was moderately effective in performing its SBT/SUW business registration functions. We noted a reportable condition* related to business registration (Finding 1).

FINDING

1. Business Registration

The Department had not implemented a process to identify and register businesses that failed to register with the Department as required by statute. The Department's failure to identify unregistered businesses could result in a loss of business tax revenues and impede the Department's ability to monitor businesses for compliance with tax payment requirements.

Section 205.1 of the *Michigan Compiled Laws* states that the Department is responsible for the collection of State taxes, assessments, licenses, fees, and tax enforcement. To meet its responsibilities, the Department relies on various State statutes that require businesses to register if they impose or collect Michigan business taxes or withhold employee income tax. Beginning in 2002, businesses that fail to register with the Department are guilty of a misdemeanor punishable by a fine of not more than \$1,000 or imprisonment for not more than one year, or both. Once registered, businesses must file periodic returns and pay any applicable taxes due. The Customer Contact Division (CCD) is responsible for processing business registrations, and the Discovery and Tax Enforcement Division (DTED) is responsible for identifying unregistered businesses. As of June 30, 2005, the Department's business registration database contained approximately 526,000 registered businesses.

* See glossary at end of report for definition.

Our review of the Department's business registration function disclosed:

- a. The Department did not have a process to identify unregistered businesses.

The Department relies on businesses to register with CCD. Relying on businesses to register is not the most effective method of ensuring compliance with the registration requirements.

The Michigan Employment Security Act requires that all employers liable under the Act provide wage detail information on a quarterly basis to the Michigan Unemployment Insurance Agency (MUIA) for each covered employee with wages during the calendar quarter. All active Michigan businesses that submit quarterly wage detail reports to MUIA should also be registered with the Department for applicable State business taxes. We used the MUIA quarterly wage detail reports as a source for performing data matching procedures with the Department's business registration database.

Our comparison of businesses' federal employer identification numbers (FEINs) reported on the MUIA quarterly wage detail reports with FEINs contained in the Department's business registration database for the period January 1, 2005 through June 30, 2005 identified approximately 7,200 businesses that were not registered with the Department. Approximately 1,700 of these businesses had submitted tax payments to the Department; however, it had no record of tax payments for the remaining 5,500 businesses. These 5,500 businesses reported to MUIA employee wages of approximately \$615 million, making them liable for remitting to the Department an estimated \$19 million in Michigan employee income tax withholdings and potentially liable for an undeterminable amount of sales, use, or SBT taxes. The Department may need to perform additional analysis to verify that these businesses had not registered with the Department and submitted payments under a different FEIN.

Performing data matching procedures with the business registration database is one method to identify unregistered businesses and uncollected tax revenues.

- b. The Department did not have a process to obtain registration applications from unregistered businesses from which it received tax payments. An incomplete

business registration database impedes the efficiency of the Department's auditing and monitoring procedures and could result in the loss of business tax revenues.

For the period April 2004 through July 2005, the Department received approximately \$16.8 million in SUW and SBT payments from approximately 5,100 unregistered businesses. The Department recorded these payments in a separate account for unregistered businesses but failed to contact the businesses to seek registration.

RECOMMENDATION

We recommend that the Department implement a process to identify and register businesses that failed to register with the Department as required by statute.

AGENCY PRELIMINARY RESPONSE

The Department agrees with the finding and informed us that it has already made substantial improvements in information sharing with MUJA to identify unregistered businesses. Also, the Department informed us that with MUJA and the Department of Information Technology it has jointly developed and implemented a new business registration Web site, which enables businesses to register more efficiently. In addition, the Department informed us that it has significantly reduced the backlog of unidentified tax payments. Further, the Department informed us that it expects to implement a replacement Business Registration and SUW Tax System by February 2008.

COMMUNICATING WITH TAXPAYERS

COMMENT

Audit Objective: To assess the Department's effectiveness in communicating with taxpayers.

Conclusion: We concluded that the Department was effective in communicating with taxpayers. However, we noted a reportable condition related to refund interest (Finding 2).

Noteworthy Accomplishments: In 2002, the Department implemented a Customer Relationship Management (CRM) System that provides a comprehensive contact tracking system. The CRM System provides a mechanism for documenting reasons for customer contacts and the internal processes involved in resolution of customer issues.

In 2003, the Department implemented a quality assurance program to monitor the effectiveness of its customer service representatives' communications with customers. The program included an evaluation of the customer service representatives' audio and written screen recordings followed by feedback and training. The Department noted that the initial focus of the project was to evaluate the telephone contacts, while the evaluation of processing written correspondence (e-mail service requests, Web site self-service requests, and postal mail responses) was scheduled to begin in January 2006.

FINDING

2. Refund Interest

The Department did not process the majority of SUW refunds and office-corrected refunds* within the time frame required to avoid paying interest on the refunds. As a result, we determined that the Department paid approximately \$1.5 million of refund interest for the period January 1, 2004 through December 31, 2004, net of interest earned by the State, because of delayed refund processing.

Section 205.30 of the *Michigan Compiled Laws* requires that the Department credit or refund an overpayment of taxes to a taxpayer who has filed a claim for a refund. Also, the Department must add interest to the refund if the Department does not issue the refund to the taxpayer within 45 days after the claim is filed or 45 days from the date established by law for filing the tax return, whichever is later. Section 205.30 of the *Michigan Compiled Laws* requires that the Department pay interest at an annual rate of one percentage point above the adjusted prime rate.

The Department's Return Processing Division (RPD) and CCD each have responsibilities for processing businesses' annual SUW tax returns or individual income tax (IIT) returns along with processing taxpayer correspondence. Both of these Divisions can initiate a refund upon the determination of a tax overpayment.

* See glossary at end of report for definition.

Our review of the Department's processing of SUW refunds and IIT office-corrected refunds disclosed:

- a. RPD and CCD did not process 67% of SUW refunds within the time period required to avoid paying \$1.1 million in interest on the refunds.

The following table shows the total number of SUW refunds processed along with the net interest paid on the refunds and the average time to process the refunds with interest:

SUW Refunds for the Period January 1, 2004 through December 31, 2004

	Total Number of SUW Refunds Issued	Number of Refunds With Interest Added	Percentage of Refunds With Interest	Net Interest	Average Number of Days to Process For Refunds With Interest
CCD	4,706	1,394	30%	\$ 209,383	315
RPD	8,109	7,153	88%	841,908	166
	<u>12,815</u>	<u>8,547</u>	67%	<u>\$1,051,291</u>	

As shown in the table above, the number of SUW refunds that exceed the 45-day processing time frame indicates that RPD and CCD need to analyze the reasons for the processing delays and develop alternative procedures to reduce the processing time and the related interest costs.

RPD and CCD each have responsibilities for processing businesses' annual SUW tax returns for the approximately 360,000 businesses registered for SUW taxes and each can initiate tax overpayment refunds. RPD annually reconciles SUW tax payments remitted to amounts reported on businesses' SUW tax returns. RPD and CCD manually review businesses' SUW accounts when the tax payments remitted do not reconcile to the annual tax returns and, if necessary, issue refunds for tax overpayments.

- b. The Department did not process 63% of IIT office-corrected refunds within the time period required to avoid paying \$.5 million in interest on the refunds.

The following table shows the total number of IIT office-corrected refunds processed along with the net interest paid on the refunds and the average time to process the refunds with interest:

IIT Office-Corrected Refunds for the Period January 1, 2004 through December 31, 2004

	<u>Total Number of Office-Corrected Refunds Issued</u>	<u>Number of Refunds With Interest Added</u>	<u>Percentage of Refunds With Interest</u>	<u>Net Interest</u>	<u>Average Number of Days to Process For Refunds With Interest</u>
CCD	21,061	12,360	59%	\$ 94,207	198
RPD	4,518	3,869	86%	395,410	360
	<u>25,579</u>	<u>16,229</u>	63%	<u>\$ 489,617</u>	

As shown in the table above, the number of IIT office-corrected refunds that exceed the 45-day processing time frame, indicates that RPD and CCD need to analyze the reasons for the processing delays and develop alternative procedures to reduce the processing time and the related interest costs.

RPD initially analyzes all IIT returns for completeness, mathematical accuracy, and compliance with predefined processing rules and identifies returns for manual review. CCD is responsible for responding to taxpayer inquiries after the processing of IIT returns. Based upon the manual review of returns or correspondence received from taxpayers, RPD and CCD can issue office-corrected refunds for tax overpayments.

RECOMMENDATION

We recommend that the Department process SUW refunds and office-corrected refunds within the time frame required to avoid paying interest on the refunds.

AGENCY PRELIMINARY RESPONSE

The Department agrees with the finding. The Department informed us that during fiscal year 2004, it was operating under severe fiscal constraints that resulted in reduced staffing, elimination of overtime, and loss of temporary staff during the peak tax season, and as a result, it was not able to meet normal production targets for processing SUW refunds and office-corrected refunds within required time frames. The Department informed us that since that time, it has significantly reduced backlogs of such refunds.

MAINTAINING SUW TAXPAYER ACCOUNTS AND RESOLVING ACCOUNT DISCREPANCIES

COMMENT

Audit Objective: To assess the effectiveness of the Department's procedures in maintaining SUW taxpayer accounts and resolving account discrepancies.

Conclusion: We concluded that the Department's procedures were effective in maintaining SUW taxpayer accounts and resolving account discrepancies. However, we noted a reportable condition related to access controls (Finding 3).

FINDING

3. Access Controls

The Department did not terminate employee access to all information system applications upon employee departure.

Terminating employee access to all information system applications upon an employee's departure helps to protect information system data and resources from unauthorized modification or usage.

Section 205.28(1)(f) of the *Michigan Compiled Laws* and *Michigan Administrative Code* R 205.1003 require that access to confidential data be restricted to employees who have a need to access the data to perform their duties.

Our review of employees' access to the Department's tax payment information systems as of October 28, 2005 identified 13 individuals who had access to certain systems, but who no longer worked for the Department or had left State service and had no need for access to the systems. Department procedures require that an employee's system access be terminated upon departure from employment; however, the procedures did not have a control to ensure that the responsible Department staff prepared the appropriate employee departure documentation necessary to terminate system access for these individuals. Establishing such a control would help ensure that business registration and tax payment information remains confidential and secure.

RECOMMENDATION

We recommend that the Department terminate employee access to all information system applications upon employee departure.

AGENCY PRELIMINARY RESPONSE

The Department agrees with the finding and acknowledges that system access for the 13 individuals had only been partially deleted. The Department informed us that it has recently implemented new security policies to address such situations in the future. The Department informed us that the system access that remained with the 13 former employees did not allow and had not been used by such employees to gain access to any of the Department's applications.

GLOSSARY

Glossary of Acronyms and Terms

CCD	Customer Contact Division.
CRM System	Customer Relationship Management System.
DTED	Discovery and Tax Enforcement Division.
effectiveness	Program success in achieving mission and goals.
FEIN	federal employer identification number.
goals	The agency's intended outcomes or impacts for a program to accomplish its mission.
IIT	individual income tax.
interactive voice response (IVR)	A technology in which someone uses a touch-tone telephone to interact with a database to acquire data from or enter data into a database.
MUIA	Michigan Unemployment Insurance Agency.
office-corrected refund	A tax refund awarded to a taxpayer after the taxpayer's original tax return was completed. Often occurs with a correction to a taxpayer's tax due when the Department receives additional documentation from the taxpayer.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.

reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
RPD	Return Processing Division.
SBT	single business tax.
SUW	sales, use, and withholding.

